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In the Supreme Court of the United States

OCTOBER TERM, 1992

FIRST NATIONAL BANK OF CHICAGO, AS TRUSTEE,
PETITIONER

v.

COMPTROLLER OF THE CURRENCY

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTIONS PRESENTED

Regulations the Comptroller of the Currency promulgated pursuant to the National Bank Act require that distributions to participants withdrawing from collective investment funds be made "in cash or ratably in kind, or partly in cash and partly in kind" (12 C.F.R. 9.18(b)(6)) and, where the fund is invested "in real estate or other assets which are not readily marketable," that distributions be made within one year of a withdrawal request (12 C.F.R. 9.18(b)(4)). The issues are:

1. Whether the Comptroller's interpretation of his regulations to require that distributions be made ratably and within one year of a withdrawal request conflicts, under the facts of this case, with the duty of prudence imposed on trustees of employee benefit funds by the Employee Retirement Income Security Act (ERISA).

2. Whether the Comptroller arbitrarily construed Section 9.18(b)(6) to prohibit distributions of entire real properties.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A20) is reported at 956 F.2d 1360. The opinion of the district court (Pet. App. A21-A34) is not reported.

JURISDICTION

The judgment of the court of appeals was entered on February 14, 1992. By order of Justice Stevens, dated May 12, 1992, the time for filing a petition for a writ of certiorari was extended to and including June 18, 1992, and the petition was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner, the First National Bank of Chicago (bank), established Institutional Real Estate Fund F (Fund F or the fund) in 1972. Its 45 participants, all employee benefit plans, are sophisticated investors with investments in the fund ranging from $50,000 to $100 million. In 1990, the fund portfolio consisted of about 60 real properties valued at approximately $490 million and $59 million in cash or cash equivalents. Pet. App. A3.

During the late 1980s, when the commercial real estate market faltered, the value of Fund F's real estate holdings declined by approximately ten percent. At the same time, the bank received an increased number of withdrawal requests from participants. Because the fund did not have sufficient liquid assets to satisfy those requests, the bank fell behind in payments to withdrawing participants and, in December 1989, it suspended further withdrawals and distributions. Pet. App. A3.

In March 1990, the bank proposed a restructuring plan for Fund F which provided that any investor that wanted to make an immediate withdrawal would receive whole ownership of individual real properties. At that time, 15 participants had pending withdrawal requests, totaling approximately $135 million. Of the fund's 45 participants, 37, owning 80% of the fund's shares, agreed to the proposal. Pet. App. A4.

The bank also submitted the restructuring proposal to the Office of the Comptroller of the Currency (OCC).[1] The bank was concerned that the proposal

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[1] Under the National Bank Act, the Comptroller is authorized to grant national banks the power to act as a trustee. 12 U.S.C. 92a. The Comptroller's regulations governing the

might violate two OCC regulations. First, 12 C.F.R. 9.18(b)(6) provides that when a participant elects to withdraw from a collective investment fund, "distributions may be made in cash or ratably in kind, or partly in cash and partly in kind." In this case, the restructuring proposal called for the distribution of entire properties rather than distributions in the form of cash or a ratable share of the fund's holdings. Second, 12 C.F.R. 9.18(b)(4), which generally requires banks to honor requests for withdrawals from collective investment funds at least quarterly, provides that a fund invested in real estate or other assets not readily marketable "may require a prior notice period, not to exceed 1 year, for withdrawals." In this case, the bank proposed to honor all pending withdrawal requests, including eight that had been made more than one year before the restructuring proposal took effect. The bank sought either a ruling that its restructuring proposal did not violate the regulations or a waiver of the regulations. Pet. App. A36.

In July 1990, OCC denied the bank's request. Pet. App. A35-A49. OCC concluded that the proposal was inconsistent with the agency's longstanding interpretation of 12 C.F.R. 9.18(b)(6) requiring all distributions to participants withdrawing from a collective investment fund to be made on a ratable basis. Pet. App. A37-A42.[2] In addition, OCC declined to interpret 12 C.F.R. 9.18(b)(4) so that its one-year requirement

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powers and duties of such banks are set forth in 12 C.F.R. Pt. 9.

[2] In other words, the agency concluded that the distribution to each withdrawing participant should be made in cash or should reflect the participant's fractional interest in each of the fund's assets, but that the fund could not distribute entire real properties. Pet. App. A37.

did not apply in the circumstances facing Fund F. Pet. App. A42-A44. The agency likewise refused to waive the requirements of the regulations. *Id.* at A49.

2. The bank filed this action in the United States District Court for the Northern District of Illinois, seeking review of OCC's ruling under the Administrative Procedure Act. The bank moved for judgment on the pleadings and the Comptroller moved for summary judgment. Pet. App. A23. The district court rejected the Comptroller's interpretation of 12 C.F.R. 9.18(b)(6), relying primarily on the fact that a precursor of the current regulation (12 C.F.R. 9.17(b) (1962)) had explicitly stated that mixed in-kind and cash distributions must be made on a ratable basis. Concluding that the 1963 change in wording of the regulation had been "advertent[]," the court held that the current regulation (12 C.F.R. 9.18(b)(6)) provides that in-kind distributions need not be made on a ratable basis when combined with cash payments. Pet. App. A26, A28. The court also expressed its view that, in light of current market conditions, participants in Fund F would be better off with a right to receive whole properties than with a fractional interest in many illiquid assets. *Id.* at A29. Accordingly, the court set aside the Comptroller's ruling that in-kind distributions must be made on a ratable basis, even when combined with cash distributions. *Ibid.*

Regarding the one-year period for honoring withdrawal requests, the district court concluded that OCC's reading of 12 C.F.R. 9.18(b)(4) was correct. The court pointed out that the bank's conduct demonstrated that it was aware of the one-year requirement, had attempted to comply with it, and sought to avoid the regulation only when it had failed to honor withdrawal requests within one year. Pet.

App. A30-A31. The court also deferred to the Comptroller's decision not to waive application of this regulation, noting that its terms are "clear and uncompromising" and that the bank had incorporated the one-year requirement in the Declaration of Trust establishing Fund F. *Id.* at A33-A34. In addition, the court pointed out that, in light of its holding authorizing distribution of whole properties, the bank was unlikely to encounter the "fire sale" conditions that it contended would render compliance with the one-year requirement imprudent, in violation of its obligations under the Employee Retirement Income Security Act (ERISA). Pet. App. A33-A34.[3] The court therefore granted the Comptroller's motion for summary judgment "as to the one year withdrawal period." *Id.* at A34.

3. The court of appeals held "that the ruling of the Comptroller denying the bank's request to be allowed to restructure the fund is valid in its entirety." Pet. App. A19.

The court of appeals began by noting that the Comptroller's interpretation of his own regulation is entitled to deference. The court went on to point out that the bank's reading of the regulation would produce an irrational distinction between distributions that were made wholly in-kind and distributions that were made partly in cash and partly in kind. As the court explained, all agreed that a distribution consisting entirely of whole real properties would violate the regulation, but the bank contended that a

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[3] The investors in Fund F are all employee benefit plans, most of which are subject to Title I of ERISA. Accordingly, the fund must be managed prudently and in accordance with ERISA's other requirements. See 29 U.S.C. 1101-1114.

distribution that included some cash as well as real property would be in compliance. Pet. App. A11.

The court further noted that, because the bank's economic arguments in favor of whole property distributions applied whether or not such distributions were accompanied by some cash, the bank's suit was in fact an oblique challenge to the validity of the regulation as a whole and not simply a challenge to the Comptroller's interpretation of the clause relating to mixed in-kind and cash distributions. In effect, according to the court, the bank was asking for the creation of a "loophole" that would permit it to evade the regulation's requirement of ratable distribution "by adding a bit of cash to every distribution in kind." Pet. App. A15.

Acknowledging that the bank had made some economic arguments favoring whole property distributions, the court pointed out that the bank had failed to take into account the economic disadvantages of such distributions—specifically, loss of the diversification investors seek when they agree to participate in a collective investment fund: "[T]he recipient of a single building or other single chunk of real property must sell it before he can realize cash with which to make another diversified investment, and in the meantime he has an undiversified investment. And every time a property is withdrawn from the portfolio and given to a withdrawing participant, the diversification of the portfolio declines, to the prejudice of the remaining participants." Pet. App. A13-A14.

With respect to the language of 12 C.F.R. 9.18(b)(6), the court noted that it was impossible to say with certainty why, when the provision was amended in 1963, the Comptroller dropped the explicit requirement that in-kind distributions be made "ratably" even if accompanied by some cash. The court

concluded, however, that the Comptroller's reading of the amended terms to retain the requirement that all in-kind distributions be made ratably "is consistent with the semantics of the regulation, and though not compelled by them seems more plausible than the bank's reading." Pet. App. A16.

Finally, the court addressed the bank's argument that the Comptroller's interpretation required it to take action in violation of ERISA's " 'prudent man' standard," made binding under the Comptroller's own regulations (12 C.F.R. 9.18(c)(5)). Pet. App. A17. The court rejected the bank's contention that, under the prevailing economic circumstances, its obligation to act prudently compelled it to distribute whole properties rather than to sell assets in order to raise cash for distribution. *Ibid.* Acknowledging that an immediate sale of property in a depressed market could be imprudent (*id.* at A17-A18), the court pointed out that this problem of "[i]lliquidity" is exactly what "the one-year regulation" (12 C.F.R. 9.18(b)(4)), which gives the bank up to one year to find buyers for the properties it needs to sell, is designed to address. "Given this leeway," the court stated, "it is difficult to see how the bank in our case could be thought imprudent if it decided to sell over the course of a year a large part or for that matter the entirety of its real estate portfolio." Pet. App. A18.

The court added that the alternative of distributing fractional shares, although "not an ideal solution," was available if extraordinary market conditions made one year an insufficient period to obtain a reasonable price for the properties. Pet. App. A19.[4]

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[4] The court noted that the bank had not substantiated its argument that the savings and loan crisis had caused the market for commercial real estate to be flooded with properties

"Given a choice between comparable evils, neither could be pronounced imprudent by a court," the court concluded. *Ibid.* The court also stated, "we do not think that the Comptroller's interpretation [of 12 C.F.R. 9.18(b)(6)] does compel, or for that matter authorize, imprudent conduct." Pet. App. A17.

ARGUMENT

The court of appeals squarely held that the Comptroller's interpretation of its regulations to require ratable distributions from collective investment funds within one year of a withdrawal request does not require the bank to take any action that could be considered imprudent under ERISA's standard for fiduciary conduct. That court's decision therefore presents no conflict between ERISA and the National Bank Act, under which the Comptroller issued his collective investment fund regulations. Accordingly, contrary to petitioner's primary contention, there is no need for this Court to "harmonize" the two statutes. Petitioner also contends that the court of appeals erred by construing 12 C.F.R. 9.18(b)(6) to require ratable distributions. But the court's decision here, which is the first construction of 12 C.F.R. 9.18(b)(6) by an appellate court, is well reasoned and conflicts with no decision of this Court or any other circuit. Accordingly, this case does not present any issue warranting further review.

1. Petitioner correctly points out that the National Bank Act and the Comptroller's regulations issued pursuant to it incorporate the fiduciary standards set out in ERISA to govern the management of the funds

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for sale, thereby creating such extraordinary conditions. Pet. App. A19.

of employee benefit plans. Pet. 18-19. Petitioner argues that ERISA's requirement of prudent conduct by fiduciaries (29 U.S.C. 1104(a)(1)) compels it to distribute whole properties because neither of the alternative forms of distribution permitted under 12 C.F.R. 9.18(b)(6) as interpreted by the Comptroller would avoid large losses for the fund and for the withdrawing participants. Specifically, petitioner contends that: (1) under prevailing market conditions, the sale of properties to generate sufficient cash to satisfy withdrawal requests within the one-year limit of 12 C.F.R. 9.18(b)(4) would be a "fire sale" that would not realize the properties' true value; and (2) under any market conditions, distribution of fractional shares to withdrawing participants would result in divided ownership that would render the properties harder to sell and therefore less valuable. See Pet. App. A11-A12, A17-A19.

Leaping over the court of appeals' complete rejection of this argument and the court's holding that neither form of distribution permitted under the Comptroller's interpretation of 12 C.F.R. 9.18(b)(6) "could be pronounced imprudent by a court" (Pet. App. A19), petitioner focuses exclusively on a single sentence at the end of the court of appeals' lengthy discussion of the ERISA issue. In that one sentence, the court observed that "[t]here can be no violation of ERISA [by virtue of compliance with OCC regulations] because that statute is explicit that it shall not be construed to invalidate or impair any federal regulation." *Ibid.* (citing 29 U.S.C. 1144(d)).[5] Peti-

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[5] Section 1144(d) provides that ERISA shall not "be construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States * * * or any rule or regulation issued under any such law."

tioner claims that the court's reliance on Section 1144(d) conflicts with this Court's decisions in *Guidry* v. *Sheet Metal Workers National Pension Fund*, 493 U.S. 365 (1990), and *Patterson* v. *Shumate*, 112 S. Ct. 2242 (1992), which, according to petitioner, held that ERISA's specific provisions control over the more general provisions of other statutes. Pet. 6, 10-11. At the very least, the bank argues, the court of appeals should have attempted to "harmonize" the requirements of ERISA and the Comptroller's regulations promulgated pursuant to the National Bank Act. Pet. 8, 18.[6]

Petitioner fails to acknowledge that the court of appeals had concluded, under the facts of this case, that ERISA and the National Bank Act are entirely harmonious. ERISA requires persons managing pension funds to act prudently and, the court held, it would not be imprudent for the bank to distribute assets in accordance with the options available to it under the OCC's regulations, construed as the OCC

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[6] In fact, in *Patterson* and *Guidry* this Court did not broadly hold, contrary to Section 1144(d), that ERISA preempts other federal laws, but instead harmonized the laws at issue. The ERISA provision at issue in both *Guidry* and *Patterson* was the statute's anti-alienation provision (29 U.S.C. 1056(d)(1)), which requires that "[e]ach pension plan shall provide that benefits provided under the plan may not be assigned or alienated." In *Patterson*, the Court held that ERISA was "applicable nonbankruptcy law" within the meaning of 11 U.S.C. 541(c)(2), a provision in the Bankruptcy Code, so that the anti-alienation provision should be given force in bankruptcy proceedings. 112 S. Ct. at 2248. In *Guidry*, the Court reconciled ERISA's anti-alienation provision with 29 U.S.C. 501(b), a provision in the Labor-Management Reporting and Disclosure Act authorizing unions to obtain "other appropriate relief," by holding that a union may obtain a judgment against a faithless officer but may not collect it from his pension account. 493 U.S. at 376.

construes them. Pet. App. A18-A19. Thus, no statutory conflict is presented by the facts of this case. Accordingly, the court of appeals' invocation of Section 1144(d) was entirely unnecessary to its judgment. In the absence of any conflict between the requirements of ERISA and of the Comptroller's collective investment fund regulations, this case does not provide an occasion on which this Court needs to address the scope of 29 U.S.C. 1144(d).

2. Nor is review warranted to consider petitioner's challenge to the OCC's ruling that 12 C.F.R. 9.18(b)(6) requires ratable distributions.

In construing 12 C.F.R. 9.18(b)(6), the court of appeals appropriately noted that it owed deference to the Comptroller's interpretation of his own regulation. Pet. App. A11. This Court has frequently recognized "the established proposition that an agency's construction of its own regulations is entitled to substantial deference." *Lyng* v. *Payne*, 476 U.S. 926, 939 (1986) (citing *United States* v. *Larionoff*, 431 U.S. 864 , 872 (1977), and *Udall* v. *Tallman*, 380 U.S. 1, 16-17 (1965)). As the court of appeals observed, this Court has emphasized this principle specifically in the context of the Comptroller's investment regulations. Pet. App. A11 (citing *Investment Co. Inst.* v. *Camp*, 401 U.S. 617, 626-627 (1971)).

The regulation at issue here, 12 C.F.R. 9.18(b)(6), states in pertinent part that "[w]hen participations are withdrawn from a collective investment fund, distributions may be made in cash or ratably in kind, or partly in cash and partly in kind." The Comptroller correctly rejected the bank's argument that the second clause ("partly in cash and partly in kind") permits non-ratable in-kind distributions so long as they are accompanied by cash payments. As the court of appeals recognized, the Comptroller's

interpretation is not only "consistent with the semantics of the regulation," but is also "more plausible than the bank's reading." Pet. App. A16. The first clause ("in cash or ratably in kind") authorizes two forms of distribution. This clause, which itself contains the conjunction "or," is set off by a single comma from the second clause. That second clause ("or partly in cash and partly in kind") simply permits the two methods of distribution already mentioned to be combined in a single distribution. If the regulation were intended instead, as the bank insists, to authorize three distinct forms of distribution—(1) cash distributions, (2) ratable in-kind distributions, and (3) a combination of cash and *non-ratable* in-kind distributions—the much more obvious construction would have been to list the three alternatives, each one set off from the others by commas. The Comptroller's conclusion that the second clause does not introduce a third and totally distinct form of distribution, but rather simply permits a combination of the two alternatives authorized in the first clause, is the better reading of the regulation.

Moreover, the Comptroller's interpretation is essential to give effect to other provisions of the collective investment fund regulations. As in any case involving statutory or regulatory construction, the Court "must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy." *Philbrook* v. *Glodgett*, 421 U.S. 707, 713 (1975) (quoting *United States* v. *Heirs of Boisdoré*, 49 U.S. (8 How.) 113, 122 (1849)). Pursuant to 12 C.F.R. 9.18(b)(3), "[a]ll participants in the collective investment fund shall be on the basis of a proportionate interest in all of the assets." An interpretation of the second clause of Section 9.18(b)(6) to permit distribution of entire real

properties to individual participants withdrawing from a collective investment fund would ignore the participant's rightful claim to a "proportionate interest in all of the assets" under Section 9.18(b)(3).

Furthermore, as the court of appeals recognized (Pet. App. A11-A12), the explicit requirement in the first clause of 12 C.F.R. 9.18(b)(6) that purely in-kind distributions be made on a ratable basis would, as a practical matter, be vitiated if the second clause permitted non-ratable in-kind distributions so long as they were accompanied by cash payments. As the Comptroller pointed out in his decision, "[t]o read the clause 'partly in cash and partly in kind' to allow nonratable distributions would allow a Trustee to evade the intent of the regulation through the inclusion of a nominal amount of cash." Pet. App. A42.

Read in the context of the collective investment fund regulations as a whole, the Comptroller's interpretation of 12 C.F.R. 9.18(b)(6) is not only "consistent with the semantics of the regulation" (Pet. App. A16), but is the more reasonable interpretation of the regulatory language. Contrary to the bank's argument (Pet. 21-22), this interpretation is not undercut by the regulation's history and, in particular, by the amendment of the regulation in 1963, which removed an explicit reference to ratable distribution in the second clause. Certainly, this change in the regulatory language was intentional. There is *no* evidence, however, that it was intended to implement the important substantive change urged by the bank. To the contrary, there is a reasonable linguistic rationale for the change. Not only is the phrase "partly ratably in kind" a very awkward formulation, it also creates an ambiguity: prior to the 1963 amendment, Section 9.18(b)(6) could have referred to in-kind distributions that were only *partly*

ratable. By removing the second "ratably," OCC prevented a reading whereby only a part of the in-kind distribution had to be made on a ratable basis. The change in wording thus eliminated one ambiguity even though, as this litigation demonstrates, it created another. This is precisely the kind of situation where deference to the agency's interpretation of its own regulation is particularly appropriate.

The Comptroller's interpretation of 12 C.F.R. 9.18(b)(6) to preclude non-ratable in-kind distributions not only is consistent with the language of the regulation, but also rests on important policy foundations. Collective investment funds are intended to permit participants "to enjoy greater diversification and wider investment opportunities than would otherwise exist." *Investment Co. Inst.* v. *Conover*, 790 F.2d 925, 928 (D.C. Cir.), cert. denied, 479 U.S. 939 (1986). Petitioner's interpretation of the regulation to permit non-ratable in-kind distributions would undermine this goal by disregarding the important principle of proportional ownership by all participants of all assets of the fund. As the court of appeals recognized (Pet. App. A13-A14), when assets are distributed on a non-ratable basis, the withdrawing participant loses the advantage of diversification of its investment. Likewise, the remaining participants lose their interest in the particular asset or assets that are distributed, and the fund as a whole becomes less diversified.

This problem is particularly acute where the assets of a collective investment fund consist of real property. Real estate values are volatile, and individual properties are unique. A property distributed to a participant today may, for any number of reasons, skyrocket in value tomorrow. The remaining participants will have lost their interest in this profit.

Conversely, the withdrawing participant may receive property today that next week depreciates significantly in value because of a natural disaster or other unforeseen event. Moreover, even in the absence of unexpected drastic changes in property values, distribution of entire properties to withdrawing participants shackles them with property management responsibilities that they never intended to assume.

In light of its consistency with the language of the regulation and its sound policy foundations, the Comptroller's interpretation of 12 C.F.R. 9.18(b)(6) to preclude distribution of whole properties to participants withdrawing from a collective investment fund is not arbitrary and capricious.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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